RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Feb. 25, 1998 **LETTER 1246**

Feb. 13 DJIA 8370.10; PTI 5249; A-D Ratio +11.30
Feb. 20 DJIA 8413.94; PTI 5257; A-D Ratio +11.44
Dow Yield: 1.66%; Dow Price/Earnings: 21.7
Dow 144-day MA: 7834; Dow 34-day MA: 8109
Dow Times Book Value: 5.95; PTI 89-day MA: 5163
Percentage of Undervalued Blue-chips: 2%
Gold 34-day MA: 297

THE MARKET: On February 10, after six months of keeping us guessing, the Dow finally surged above its August 6 peak of 8259.31 to close at a new all-time high. In doing so, the Dow confirmed the prior record highs in the Transportation Average. Thus, February 10, for the first time since August 6, saw both D-J Averages at new record highs. The primary trend of the market was thereby re-confirmed as bullish.

What does this mean for investors? With the market at its current rarefied height, the February 10 re-confirmation, in Dow Theory terms, means less than the same action would have, had it occurred early in the bull market, say in 1975 or 1985. Nevertheless, just as a persistent non-confirmation makes us nervous, **a bullish re-confirmation is comforting. It's nice to know that this is a newly re-confirmed bull market.**

The bonds, the bonds: A major force behind the continuing rise in the stock market are the bonds, which is another way of saying -- lower interest rates. Remember, the **lower interest rates go, the more generously the market capitalizes stock earnings.**

Here's a scenario which I believe we could be seeing by late spring or summer. The Asian mess remains a mess (last week, by the way, Vietnam devalued its currency). Japan remains in recession. In the face of rising unemployment and towering inventories, China shocks the world by again devaluing its yuan. Reacting to the Chinese move, Asia embarks on another round of competitive devaluations. Profit growth for US corporations declines to zero or even goes negative. In the face of zero profit growth the CPI goes negative (meaning actual deflation) and the yield on the long bonds moves down to near a 5% rate, maybe even breaks 5%. In response to deflation and record low rates for the long bond, the stock market either declines or lapses into a trading range. Happy scenario? Depends on where you are and what you own.

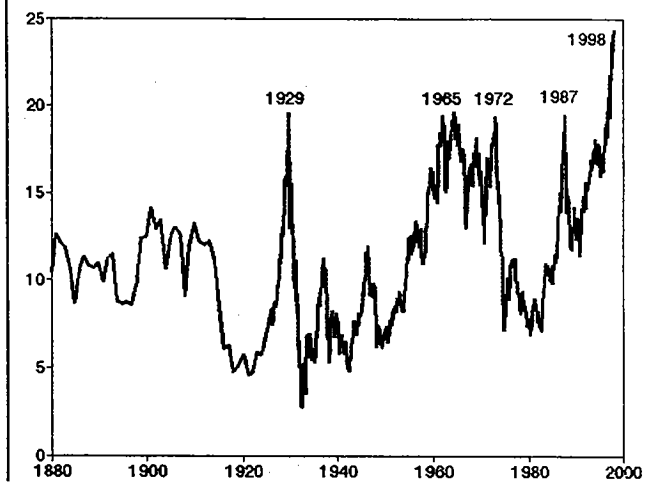
What's the technical situation in the market now? **(1)** The D-J Industrials and the Transports have advanced to new bull market highs together -- clearly bullish action. **(2)** Average volume at or near record highs -- bullish. **(3)** My Primary Trend Index (PTI) at or near record highs -- bullish. **(4)** Bonds in a rising trend -- bullish. **(5)** Majority of daily most-active stocks consistently on the plus side -- bullish.

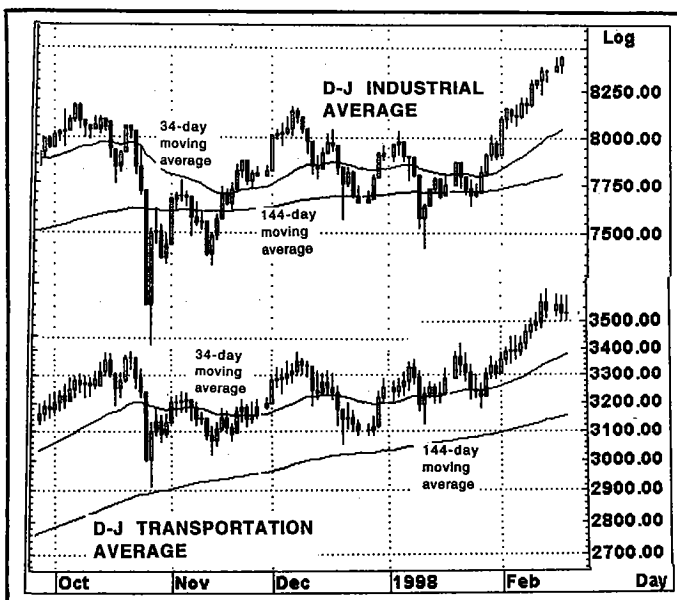
At this point it is well to remember that a basic tenet of Dow Theory is that **neither the duration nor the extent of a primary move can be predicted in advance.** And certainly, this bull market has provided ample proof of that time-honored axiom. None of us at the depths of 1974 or even at the lows of 1980 or 1982 could have predicted that in 1998 the Dow would be well over 8,000.

In my own experience, the three most difficult things to do in investing are: **(1)** to ride a bull market, while fully invested, all the way up to somewhere near its ultimate top; **(2)** to get out and stay out of a bear market until it hits its final bottom; and **(3)** to enter a new bull market anywhere near its beginning.

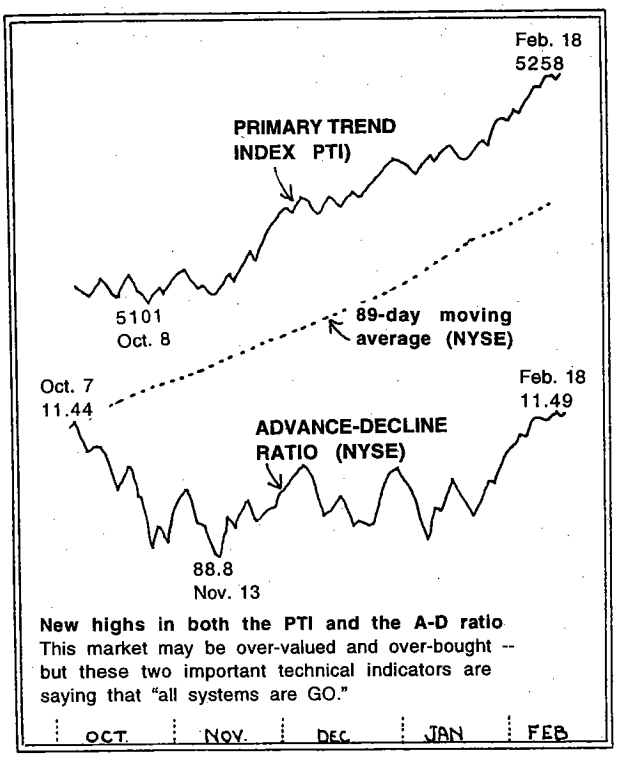
HIGH, VERY HIGH: We know the market is acting well, so is there any reason at all for caution here? Yes, there is -- from the standpoint of valuations. Here are Standard & Poor's latest statistics for the Dow and the S&P Composite. The S&P earned 40.64 for the latest 12 months. This means that the S&P is selling at **25 times record earnings.** This is the highest P/E ever applied to record earnings. Historically, the average price that the S&P has sold as a multiple of record earnings is 12. *Hussman Econometrics* [(800)487-7626] has done a good deal of excellent work in this area, and in their latest report they include a chart which traces 100 years of the S&P price as a multiple of record earnings.

A CENTURY OF VALUATION: PRICE/RECORD-EARNINGS





You can gauge the strength (or weakness) of any item by monitoring the **spread** between the two moving averages. Currently, both D-J Averages are strong with the Transports exhibiting considerably more strength than the Dow.



New highs in both the PTI and the A-D ratio This market may be over-valued and over-bought -- but these two important technical indicators are saying that "all systems are GO."

The chart is astounding. We see that in 1929 the S&P sold at 20 times record earnings, followed by history's most horrific bear market. In 1965 we saw a ratio of 19 -- this was followed by a total return for stocks of zero over the next 10 years. In 1972 the S&P sold at 19 times record earnings -- this was followed during 1973-'74 by a catastrophic bear market. In 1987 the multiple was 20, and most of us are well aware of what happened in '87.

Now here in 1998 the S&P is selling far above any of those previous periods of record earnings. What does this mean? For one thing it means that stock buyers are most optimistic, more willing to pay high prices, more willing to assume risk, than at any other time in history.

And you have to ask, "Why are market participants so extraordinarily bullish here in 1998?" I've recounted my reasons before, but here are a few again. **(1)** The great majority of stock owners today have never experienced a true bear market. **(2)** The rise of thousands of mutual funds have made it easy for the public to participate in the market. **(3)** The cultural obsession today is with money. Whether you're reading about the latest basketball salaries or the gross on the "Titanic" movie or the latest tally on Bill Gates' wealth, it's money that makes the headlines. **(4)** With fears of the demise of Social Security, people feel that they must provide for their own financial futures -- and stocks, they believe, offer their best and even surest avenue. **(5)** Finally, and this is from the *Liscio Report* [(212)685-7231]: "The economy's growth in 1997 was the strongest in nine years; the unemployment rate is the lowest in 24 years, and inflation the best in 11 years."

My view: In view of John Liscio's comments, you really can't blame the public for being bullish on stocks. Liscio relates FACTS, but veteran market practitioners know that "all facts are history." So as I see it, this is by far the most expensive and optimistic market in Wall Street history. But caution -- it's a market that is **not prepared or priced for any negative surprises.**

I think two news factors will be critical in '98. The first is how important the Asian collapse will be as far as global business and competition is concerned. There's also the question of whether the Asian meltdown will generate disinflation or actual deflation in world and US markets. I can tell you this -- the Asian fiasco is beginning to hit California's trillion dollar economy (the Cal economy is the seventh largest in the world). In January, for the first time in nine months, the number of 20-foot containers (used in exports) showed a drop-off. Furthermore, ships arriving at Cal ports from Asia fully loaded are leaving only 30% to 40% loaded.

So let me put it this way -- in view of the age and uncorrected character of this bull market, it is probably vulnerable to any unexpected negative event. However, until we run into such a "surprise," for the best indication of what's actually happening, we'll **follow my Primary Trend Index.** And so far, the PTI continues to do what it's been doing ever since 1994, namely, either advancing to new highs -- or moving sideways and then advancing to new highs. We'll watch for any change.

Important: For my very latest thoughts see **Late Notes** on page 6.

Items: US wholesale prices declined 0.7% in January, thereby registering their steepest decline in 4.5 years. **China** reported its fourth consecutive month of year-over-year declining retail prices. That's called deflation.

INVESTMENT POSITION: We old-timers have a hard time with this market. The reason is that we grew up respecting values, yields, parameters, and always the possibility of loss as well as gain. Those are all factors that this market has ignored for many months -- uh, make that years.

In the last Letter I confessed that I, personally, had no stocks at this time. I am totally in Treasury bonds, notes and bills, all securities that I've been recommending for some time. Why bonds? Simple, because bond yields are just below 6%, because bonds are in an up-trend, because I think the US faces a slowdown (courtesy of Asia), and because Treasury paper has the full faith and credit of the US government behind it.

The latest Merrill Lynch "Global Research Highlights" publication states, "Recent data suggests that US economic activity is beginning to react to the Asian crisis. We continue to expect economic growth to moderate in 1998 while inflation trends lower . . . Interest rates might move far lower than many market participants currently expect. We think that long-term yields could slide to 5% or less at the first signs that the economy has slowed down significantly."

Russell opinion: As for stocks, there's no dividend return from stocks, unless you're satisfied with 1% to 2% a year. So if you buy stocks here you're in the position of having to hope they'll go up. They must go up. Otherwise, you're just sitting with shares that are providing the lowest yields in stock market history.

Remember, historically, stocks over the years have provided a total return of about 10.5%, half of which came from dividends. But with the yield on the S&P currently at 1.55%, that means that stocks will have to advance by 9% this year just to provide the historical average rate of total return.

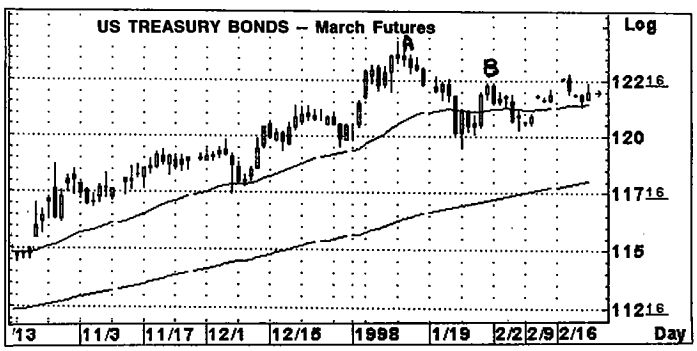
Question -- would you rather buy a 5.80% return in Treasuries or bet on a 9% increase in stocks? My own choice -- I'll take the 5.8% return on bonds. And if the bullish trend in bonds continues, I might receive a total return of better than 5.8%.

In the March issue of *Smart Money* magazine, writer Ben Stein makes the case for buying "the market" via "Spiders" on the AMEX (which are S&P depository receipts for the S&P 500) rather than trying to pick individual stocks which you hope will beat the market. Frankly, I think at this point the Spiders approach is a good one, and it will probably beat the great majority of individual stock picks and mutual funds.

More recently, the Dow Jones "Diamonds" are offered on the AMEX -- a Diamond is comparable to the Spiders with each Diamond worth 1% of the D-J Industrial Average.

BONDS: This is a chart of the March Treasury bond futures. Last week the bonds broke out above the preceding peak marked "B" on the chart. It seems to me that the bonds have gotten a bit ahead of themselves and you can see this by the wide spread in the two moving averages.

The next target for the bonds would be to close above the peak closing high (Jan. 12 at "A") of 123 23/32nds. The bonds may have to fluctuate sideways for a while before they attack the high. The 34-day MA for the bonds stands at 121 13/32nds, and it would be "nice" if the bonds on any forthcoming weakness would hold above that level. The trend of bonds will **remain bullish** until proved otherwise.



NOTES & QUOTES: Ah, what to do about Saddam? Bombing, the "half-way war," won't solve the problem and will arouse world opinion (particularly Arab opinion) against the US. Negotiations with Saddam are a joke (he never honors agreements). Using land troops would entail US casualties, and Clinton wouldn't do anything that might result in a decline in his popularity. So what's left? I guess it would be trying to strengthen the forces within Iraq in the hope of an internal revolution (a wispy hope). I've never been a fan of Colin Powell, a guy who got where he is to a large extent by playing it safe. Desert Storm was our one golden chance to move in and get rid of Saddam once and for all, but Colin Powell and James Baker argued that the US public wouldn't stand for a "turkey shoot" whereby advancing US and UN troops would mop up Saddam's retreating Republican Guard and go all the way -- ultimately taking Saddam out. Saddam knows that bombing Iraq is a useless tactic. He also knows he's dealing with a US president who is weakened and besieged by scandals. **Russell View:** We waited far too long -- and the longer we wait the more difficult or impossible it will be to get rid of Saddam and his weapons. Only one way to oust Saddam -- go in with air power and ground troops and take him out once and for all. But neither Clinton nor his advisors have the will to do this.

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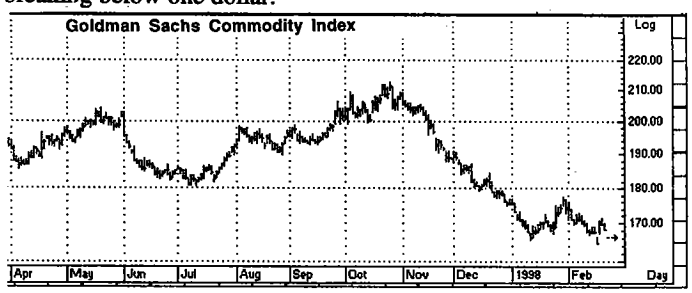
I read a lot (and I mean A LOT) and the best stuff I read regarding Asia comes out of *13D Research* and my old friend Kiril Sokoloff. Kiril writes, "It is so tempting to become bullish on Asia. The Asian model is still alive, if only a little tarnished, and is ripe for a Mexican-type recovery. . . . Japan will finally do the right thing and stimulate its economy, pulling the rest of Asia out of recession . . . The Asian outlook largely hinges on Japan and China. Will the Japanese stimulus plan work and will the Chinese avoid a devaluation? These are complex issues, of course, but in this paper we argue a **negative outlook for both issues.**" Kiril, in a brilliant and incisive discussion, demolishes the idea that all is turning out well in Japan or that China is in good shape and will never devalue the yuan. **Russell Comment:** My own opinion is that both Japan and China are in rotten shape, and that their problems will rub off increasingly on the US. The Asian nations account for one-third of the world's GDP, and when their markets and currencies collapse, it's difficult for me to see how this will not impact on the Western economies. All this will take time, but I think by spring we will see the Asian problem start hitting the US, maybe harder than expected.

* *

If you're dealing with commodities, you already feel the deflationary winds coming out of Asia. Bill Gary [*Price Perceptions,* (800)231-0477] notes that the Asian collapse has been a nightmare for producers of commodities. Writes Gary, "The US eliminated price support programs and gave farmers freedom to produce for a growing world marketplace. US livestock producers expanded herds in anticipation of record exports to Asia. South America expanded soybean and wheat and corn acreage dramatically . . . There appears to be a general belief that the Asian crisis is over and recovery is just around the corner. However, there is little evidence at this time to support that belief. It appears that **farmers and livestock producers have increased production for a market that no longer exists." Russell Comment:** Gary knows what he's talking about. Here's the Goldman Sachs Commodity Index and you can see what's been happening. On February 3, the Index gave a new sell signal as it sank below its 34-day moving average again. **Note:** Crude oil futures are now under $16 and regular gasoline prices in the US are breaking below one dollar.



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A lot of analysts are scratching their heads, trying to figure out what Warren Buffett, "the Sage of Omaha," is thinking and doing. Here's my view. Buffett has basically bought and held big-cap, efficient, consumer-products companies like Coke, Gillette, McDonalds, even See's Candy. The growth of these companies has been terrific, but I think Buffett sees these companies as heading for slower growth; furthermore, he feels they are now fully priced if not over-priced. In fact, when the "mini-Berkshires" came out over a year ago, Buffett warned that he himself wouldn't buy them. I think Buffett now thinks that the market is a bit dangerous. Lately Buffett has bought (1) zero T-bonds, and (2) silver. What's interesting is that both of these are not common stocks. I think Buffett feels that whatever bargains are around, they are **not in stocks,** and that bargains are possibly in commodities, and, of course, silver is both a precious metal and a commodity. The fact that Buffett is not taking additional stock positions at this time may be viewed as a warning. Anyway, that's the way I see it.

* *

When I was a kid, going out to a restaurant was a big deal. Every other Sunday or so my father would announce that we were going out for dinner. I remember (this was around 1939) that our Sunday dinner at the Famefood restaurant on 72nd Street (NYC) just off Broadway was 90 cents for a full four-course dinner. When Famefood raised the price to $1.10 my father was furious and said that we wouldn't eat there anymore. What about today? Today America eats out. There are 799,000 restaurants in the US today employing 9.5 million workers. Restaurants now account for 44% of all dollars spent on food. Statistic: NYC has 14,500 restaurants; seven out of every 10 of these restaurants go out of business within five years of opening. Note: All the biggies of the restaurant business are now opening in Vegas. Spago in Vegas is now grossing an incredible $15 million a year, more than Spago in LA. Note: Now if only Americans would drink more wine. 80% of Americans don't drink wine at all. The average American drinks 2 gallons of wine a year. The average Frenchman drinks 19.2 gallons, the average Italian drinks 16.2 gallons.

* *

The broad M-3 money supply has increased by 9.3% over the last six months. Somewhere along the line (how far ahead I don't know) it's at least logical to believe that inflation will heat up in the US again. If it does then the Fed will be forced to fight it with higher interest rates. Such action would come with the market up on stilts, expensive and uncorrected. And that could be the trigger for the next bear market. But could it be a BIG bear market? I think it could. One reason it could is that the **public is so heavily invested in common stocks.** Thus, a market that is heading

down would generate a "reverse wealth effect." As people watched stocks (which are now a large part of their life savings) heading down they would "pull in their horns," cut back, head for the storm cellar. This, as I see it, is the most logical scenario for the next bear market. If I had to guess, this is the way I believe it will happen.

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In a headline piece in the *NY Times* (Feb. 11) the paper noted that Americans now have more of their wealth tied up in stocks than they do in their homes. Writes the *NY Times,* "Stocks accounted for 43% of financial assets, which include bank accounts, mutual funds and securities."

* *

Mania?: A NYC auction of Titanic memorabilia brought in prices 15 times estimates and electrified auctioneers. A volume of dramatic distress signals from the Titanic sold for $180,000. The centerpiece, bought for $123,000, was a volume containing 34 signals from or about the Titanic from radio-room logs of three other ships.

* *

SHARE OF WEALTH IN STOCK HOLDINGS HITS 50-YEAR HIGH

HOME SLIPS TO NO. 2 ASSET

Households Put 28% at Stake, Raising Fears of Extra Pain Should Downturn Come

By EDWARD WYATT

After three years of rapidly rising stock prices, American households have more of their assets invested in the stock market than at any time in the last 50 years — and perhaps ever.

Savings: Are Americans so bullish that they don't care about saving any more? Or are Americans so bought-up that they can't save? Or are Americans pouring all their "extra" money into the stock market on the thesis that stocks represent their "new savings"? Nobody knows, but they do know this -- the savings rate in '96 was a very low 4.3%. But in '97 savings dropped to the lowest point since 1939, down to 3.8%. One theory -- households are cashing in some of their assets either to pay bills or to buy stocks. Time will tell.

* *

Here's a surprise. The US birth rate has fallen to an historic low. The birth rate has fallen 13% since 1990 and 38% since 1960. Demographers say the birth rate is falling because the baby boomers are moving out of their child-bearing years (ages 15 to 44) and the older generations are living longer. Actually, the only thing that keeps the US population from contracting is strong immigration. My own theory about why the birth rate is falling is that it's become so expensive to raise kids, and consequently couples are limiting the size of their families. Also, in the old days people depended on their kids to support them in their old age; now we have Social Security.

* *

Business Week's Feb. 16 cover story is, "The Entertainment Glut." Even while the movie Titanic moves into what could be a record gross, the feeling in the industry is that there is simply too much of everything being generated. The major networks are losing audiences while the Internet gains a bigger audience; cable competes with satellite TV where hundreds of stations are offered; the stores are choking on VCR tapes, Broadway offers more shows than it has in years (plus a slew of off-Broadway shows), and movies are coming out faster than viewers can watch them. Finally, sales of hard-cover books have been declining since '94. As for magazines, there are thousands being offered on every subject from roses to fashion to the hundreds of ubiquitous pornos. Actually, over 25% of all VCR rentals are porno. A triumph -- the British film, "The Full Monty," is every film-makers dream. Why? It grossed a record $78 million in Britain and over $200 million worldwide. Cost of "The Full Monty" -- $3.5 million.

* *

Waiting for campaign reform? Forget it; it's not going to happen. Neither party really wants it, and they hope the public will just forget about it. Past efforts at reform have been killed by filibusters in the Senate 17 times since 1980. This time campaign reform won't even get to the filibuster stage.

* *

The burgeoning money supply is finally beginning to rub off on housing. In California, housing prices are up 8% over last year. In the Bay area, housing is going sky-high as is the case in luxury housing in New York. Recently a 5,400 square-foot East Side apartment in NYC sold for $13 million or a record $2,400 a square-foot. The previous record was when Jackie Onassis' apartment sold on Fifth Avenue for $1,900 a square foot. Prices are surging in the City with million dollar condos scarce and in demand. With the Wall Street bonuses now coming in, the new signature of wealth is expensive wine. Writes the *NY Times,* "A big wine splurge is taking place all over New York City, a leap in high-end consumption that began in early December and shows no signs of letting up, with the wine bill for a table of four sometimes running into the thousands of dollars . . . A senior editor of the *Wine Spectator* said, 'I think wine has taken over from the toys of the old days like watches and cars. Wine shows that you have money, but it also shows that you have taste.'"

* *

The old thesis that "people vote their wallets" was never truer than in the present situation where an incredible 80% of Americans believe that Clinton is doing a good job as President. Yet the majority of those polled think Clinton was lying when he said he never had sex with Monica. So the American people are willing to accept a President who can look them in the eye and lie and deny. To me, this is an indictment of US morality as well as Presidential character. It's all beyond me -- I was brought up to admire George Washington who reportedly admitted after chopping down the fabled Cherry Tree, "I cannot tell a lie." Against the legend of Washington, we are now treated to one of the most scandal-ridden presidencies in US history. Love of money, it seems, conquers all.

I was asked recently who I thought was the last thoroughly honest US president. I named the incompetent but honest Jimmy Carter, and before him the competent and thoroughly honest Harry Truman. Truman once said, "Men who will do anything to get into the White House should be disqualified from entering it." In 1956 Truman received an honorary degree from Oxford University. To a man who had been at the pinnacle many times before it was just another ceremony. But matters became more solemn as the ceremony continued. When it was said of Truman, invoking lines from Virgil, "Truest of allies, direct in your speech and writing, and ever a pattern of simple courage," Truman burst into tears. There, there was an honest man and one worthy of being President of the United States (with thanks from subscriber Leo Burns for much of the above).

This from a Cal Thomas syndicated column: "When King David committed adultery with Bathsheba and sent her husband off to be killed in battle, the prophet Nathan confronted the king. This led David to confess his sins and repent. Today, David would have hired a good criminal defense attorney and used his palace staff to spin for him and smear the prophet."

My secret suspicion: I think Clinton is seriously split and extremely neurotic. Politically he won't make a move without taking a poll. But in his personal life he can't resist walking on the edge of the cliff (forbidden thrills). Frankly, it wouldn't surprise me if he continued his insane and dangerous sexual behavior, and he could even get caught again, which would be totally in character (of course, if he's caught again he's finished). But nothing would surprise me with this man.

* *

Faye and I just returned from a whirlwind three-day trip to NYC to attend Marty Zweig's gala wedding. Marty and Barbara were married at the new (old) Cipriani, a giant banquet hall down on 55 Wall Street. The place will soon be the luxurious Cipriani hotel. It was a fantastic wedding with 400 attendees (black tie). Marty and his new bride couldn't have looked happier. At the huge wedding were many old friends, including Bob Nurock, Ned Davis, Ed Hyman, Jim Rodgers, and Louis Rukeyser (my mom used to date Lou's father, Merril, back in the '20s). The Cipriani building brought back memories. At one time it was headquarters for the old National City Bank. Back in the '50s it was the home of the New York Mercantile Exchange. I used to walk over to the Exchange (I

worked in that area) where a friend of mine was one of the chalk boys. There was a giant blackboard at the Exchange, and my friend would stand up on the raised platform and write in the latest prices (in chalk) for potatoes, poultry, onions, and I forget what else. Those were the pre-electronic days, when Wall Street was all ticker-tape and chalk . . . By the way, we're drowning in rain here in California, whereas we froze in NYC. First thing I did when I got back to La Jolla -- jumped in a hot bath tub to thaw out.

* *

Now that the networks have paid "through the nose" for the rights to broadcast NFL games, the same networks will have to sell the games to their affiliated stations. And that's where the trouble comes in. The networks (in order to cover the huge costs that resulted from their NFL deal) want to raise the price (co-financing) to their affiliated stations. And the stations, to pay those bills, will in turn have to boost the charges to their advertisers. Will the advertisers pay the increased costs? That's the question, but already there are objections. Says William Croasdale, president of the national broadcast division of Western International Media, "There is no way that the ad budgets are going to increase for football to cover these rights fees. My gut feeling is that at least for the first year and possibly for the life of the contract, they will write red ink." **Russell Comment**: Yeah, I think the NFL got too greedy, and the broadcasters (in desperation) paid far too much for the NFL rights. In the meantime, viewership to the Winter Olympic games has dropped 17% below what CBS promised its advertisers, and this means costly rebates.

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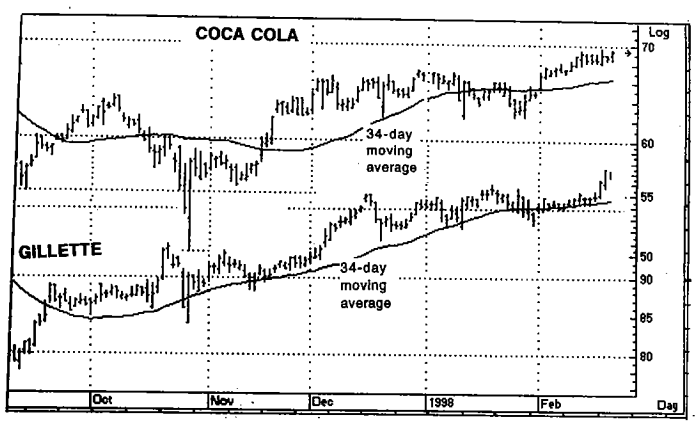
Financial World magazine some months ago published what could be a most significant article about Coca Cola (Warren Buffett owns 8% of this stock). Believe it or not, Coke (KO) is the second largest capitalization stock on the Big Board at around $175 billion (GE is first with a cap of over $235 billion). But *FW* warns, "If the stock stumbles, so could the rest of the market. Why? Because Coke is the bellwether for the consumer non-durable stocks, which have been the stars of the bull market over the past few years." *FW* notes that, "Coke revenues rose only 3% in '96, after an 11% gain the previous year. And despite price cuts on some products, demand has remained weak this year . . . Coke management also says revenues -- 69% of which come from outside the US -- have been hurt by the recently strengthened dollar." But the big problem is that operating income actually declined 2.8% in '96, which is "not the stuff of a growth stock." With capitalization around 9 times its $18.5 billion in sales, the market values KO very richly (in comparison, GE capitalization is only 3.3 times sales). Note on the chart, that Coke moved sideways in the 62-67 range from November through January. In January KO broke out to a high of 68, but since then nothing much has happened. The 34-day MA for KO stands at 65.

Gillette, another big Buffett holding, is a second important consumer stock that is worth watching. Gillette has fluctuated in the 97 to 104 area from December to the present. A breakout of this range, either way, would be important for the market. Gillette is sitting on its 34-day MA, which now stands at 99.



I mentioned this in the last Letter, but I think it's worth repeating: the Clinton administration and Greenspan have opted to put another $18 billion with the IMF for the purpose of bailing out Asian nations. So far, the plan isn't working; Congress won't go along with it. The sentiment among many Congressmen is, "Let 'em stew in their own juices, we're tired of bailing out other countries with US dollars." It looks like a long fight.

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Where the money comes and goes: For every dollar the government takes in, 46 cents comes from individual income taxes, 34 cents comes from Social Security and other payroll taxes and 11 cents comes from corporate taxes. Where does the money go? You may be surprised by the following: the government spends 23 cents for Social Security (by far its biggest expense), 17 cents for discretionary spending such as education, foreign aid, 15 cents for defense (mostly military salaries), 14 cents for interest payments on the national debt, 12 cents for Medicare and 6 cents for Medicaid, and 6 cents for other entitlements such as federal retirement and farm aid, and well, this year, 1 cent for the so-called surplus. To me it's amazing that over one third (37%) of the federal budget now goes for Social Security and interest payments on the debt.

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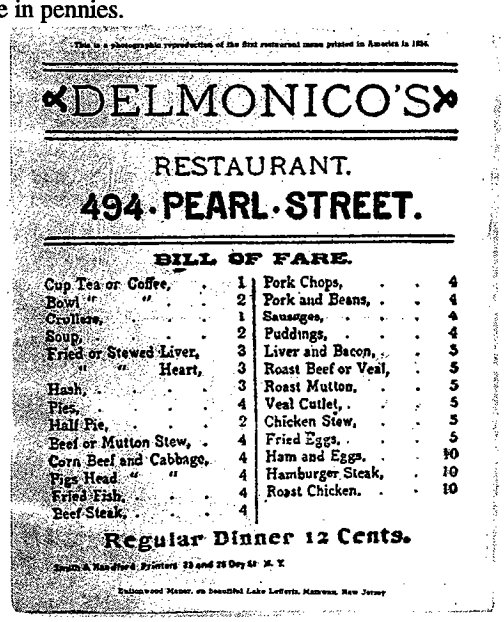
I came across this menu from the famous Delmonico's restaurant. This is one of the first printed menus in the US, date 1834. I thought the prices were interesting, and they provide mute testimony to what happens to currencies over the decades. The prices are in pennies.



DELMONICO'S

RESTAURANT.

494 · PEARL · STREET.

BILL OF FARE.

Cup Tea or Coffee,	1	Pork Chops,	4
Bowl " "	2	Pork and Beans,	4
Crullers,	1	Sausages,	4
Soup,	2	Puddings,	4
Fried or Stewed Liver,	3	Liver and Bacon,	5
" " Heart,	3	Roast Beef or Veal,	5
Hash,	3	Roast Mutton,	5
Pies,	4	Veal Cutlet,	5
Half Pie,	2	Chicken Stew,	5
Beef or Mutton Stew,	4	Fried Eggs,	5
Corn Beef and Cabbage,	4	Ham and Eggs,	10
Pigs Head " "	4	Hamburger Steak,	10
Fried Fish,	4	Roast Chicken,	10
Beef Steak,	4		

Regular Dinner 12 Cents.

CHART BOOKS AND CHART PAGES 1997: Don't ask me why but in an industry that involves trillions of dollars, nobody else does this. What I'm talking about is chart books of the **D-J Averages** and the all-important **breadth index** (i.e. advance-decline ratio). I've been offering these two chart albums for decades, and I feel they're invaluable. Actually, I started these albums back in the '60s because I needed the data myself. The first volume is a **complete daily history** of the D-J Averages (all three Averages plus bonds and volume) going back to **1885**. Important economic and world events are notated on each page. The charts are packed in a big three-ring, hard-cover binder, one page for each year. The album is yours for $140; we pay the postage in the States. The second album covers the Dow and the extremely important A-D ratio (daily) going back to 1931. Comments regarding the action are included in many of the pages (one page for each year). The price is $100, we pay US postage. **For those who own the chart books,** the new 1997 pages are ready, and the price is $5 for the page of the Averages and $5 for the new A-D ratio page. Please send your money in now (outside the States there's an extra postage charge of $35 for each album). Write to Dow Theory Letters, PO Box 1759, La Jolla CA 92038.

Take That, Dow Industrials! Co-op Tops $2,000 a Foot

By DENNIS HEVESI

Another barrier has been pierced in the already dizzying rise of Manhattan's residential real estate market: for the first time, an apartment has sold for more than $2,000 a

57th to 96th Streets on the East Side, as well as Central Park South, Central Park West and Sutton and Beekman Places.

In 1997, the average price for four-to-five-room apartments in those

THROUGH THE ROOF

Many in Bay Area feel the bite of soaring housing costs

By Gordon Smith
STAFF WRITER

PALO ALTO — When Glenn Abello moved to the San Francisco Bay Area last December, he expected it to be different from his small hometown in Pennsylvania.

He wasn't prepared, though, for housing costs that seem to be straight out of the "Twilight Zone."

A 1,500-square-foot house in many parts of the Bay Area sells for upward of $800,000. Homes larger than that in good neighborhoods are routinely priced at more than $1 million.

Even a small fixer-upper on a narrow lot is liable to cost $400,000, Abello said incredulously.

The prices are changing the complexion of many inner-city neighborhoods, even as they are chasing countless young, middle-income home buyers past a greenbelt that surrounds most of the Bay Area to a ring of suburbs more than an hour's drive away.

Abello, 53, the marketing director for a start-up maker of high-tech medical equipment, is coping by renting a contemporary two-bedroom apartment here for a jaw-dropping $3,500 a month.

"It's a rude awakening," he said. "People say the climate is better in California, but for the kind of money I have to spend, I could create my own climate" back East.

San Francisco has long been known for its pricey real estate. For more than six straight years, San Mateo, San Francisco and Marin counties have collectively been rated the least-affordable housing market in the nation by the National Association of

See HOUSING on Page A-19

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The Fed's got a problem. Asia is deflating, and it's exporting its deflation to the US in the form of cheap goods. To counter-act deflation, the Fed is allowing the US money supply to boom. Where's all this liquidity going? It's been going into financial assets, meaning stocks and bonds. And more recently, it's been rubbing off on real estate via the REITS and via housing, particularly luxury housing. On both coasts real estate prices are heading up strongly, and I imagine the same thing is happening in the Midwest and the South. These clips tell the story. In NYC you don't even want to know what's happening to luxury co-ups and condos. Here on the West Coast prices are rising and in the Bay Area prices for housing are so high that Bay Area companies can't get executives to leave NYC to move out here (and that's saying something).

Euphoric Times

Ignoring All Problems, Most People in Business Glow With Optimism

But mention the Iraqi threat today, and business leaders here politely acknowledge it and then shrug it off. They shrug off the potential of other shocks, too. The Asian crisis? The sex scandal in Washington? The possibility of a stock-market crash? Not to worry.

Here in the Detroit of the $7 billion RV industry, as in much of the country, business confidence is in overdrive, powered by a wave of prosperity and euphoria.

THE CYCLE THAT I WATCH: There's a cycle in human emotions that runs from the depths of despair to the heights of optimism and then back to the depths of despair. A study of history shows that there's no question about the cycle, the only question is the **duration**, the time it takes to go from despair to euphoria and then back to despair.

My older subscribers remember the **bottom of the last despair cycle**. It was in late-1974. At that time, with the Dow sinking to 577, we heard predictions from well-regarded Wall Street experts that the Dow "was heading for 250 or lower." Some even opined that we were seeing the end of both Wall Street and capitalism.

On December 20, 1974, I sent out what I termed my "Special Report." In that mailing I stated that I thought the odds were good that the great bear market had ended and that it was time to buy. I recommended buying a selected list of 12 stocks and I included charts of each.

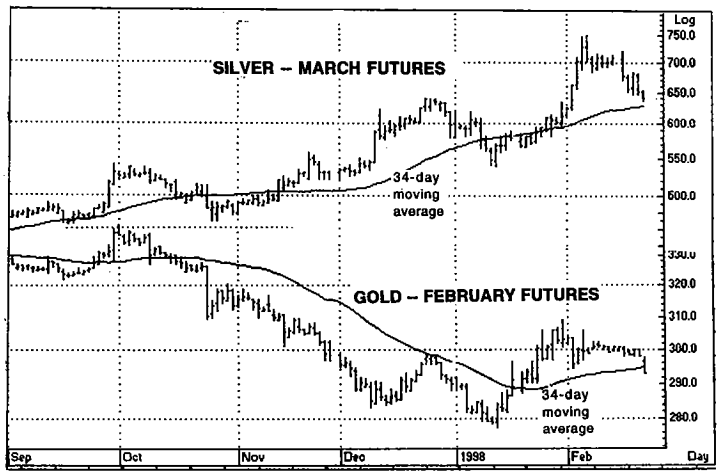
Today, I'm getting the feeling that we're pushing close to the opposite end of the cycle. This front page article from the Feb. 20 *WSJ* talks of **euphoria.** Today all news is taken as either bullish or not serious enough to worry about. The Iraq mess -- no problem. Clinton's endless scandals -- no problem. The Asian collapse -- no problem. Money supply surging -- no problem. Trade balance wildly negative -- no problem. I guess my thinking was crystallized during my trip to NYC last week. The restaurants were filled and booming. Merchandise at better stores was priced sky-high. At Bulgari I saw a gorgeous emerald ring in the window. Curious, I went inside and asked to see the ring. An enthusiastic lady brought it to me. I asked the price. The price: "$1.1 million." At Cartier I admired a beautiful "fancy yellow" diamond necklace. I asked the price: "$1.3 million." NYC is on fire. And prices are sky-high. The restaurants can't keep up with orders for $1,000 bottles of wine. Money is flowing. Worries are confined to whether one can get a decent ticket to a Broadway show (prices up to $80) or whether one can get a table at Cirque 2000.

So dear subscribers, let's harbor a "healthy skepticism," let's be careful, and let's watch to see whether BOTH the D-J Industrials and Transports can continue to record new highs. Because if they can't, if they start sliding, we might have the beginning of something. Yes, we might have that "little dark cloud no bigger than a man's hand."

PRECIOUS METALS: Deflation is a problem for the precious metals. It's also a huge problem for the gold mines, particularly the S. African mines. At least 42,000 S. African miners lost their jobs last year and more layoffs are expected. Some mines will have to shut down gold production in S. Africa peaked in 1970 at 1,000 tons. Gold production last year sank to an estimated 490 tons.

Let's look at the charts and see what we've got. The "Buffett silver explosion" took the March silver contract to a peak of 7.50. Since then, silver has backed off and on Feb. 23 it sank below 6.50. On the plus side, silver has held (but barely) above its 34-day moving average, which now stands at 6.29. Prognosis: silver trend is UP, but it's hard to be impressed by the recent action.

Gold is even less impressive. From an extreme low of 277.5 struck on January 13, the February contract rose to a January 30 peak of 308.90. Since then gold has been sliding. More discouraging, on Feb. 23 gold broke below its 34-day MA, which now stands at 295. Prognosis: no reason to buy or sell gold here, unless you're a citizen of Indonesia or Vietnam, in which case gold looks good. The dollar is in a trading range, but as long as the dollar "holds together," I doubt that gold will do much. Diamonds (not yet gold) are still a girl's best friend.



LATE NOTES: Headline Feb. 23 in *USA Today:* "UN signs deal with Iraq." Golly gee, I though we **won** "Desert Storm," and that we already had a deal with Iraq. Silly me. Ah well, maybe this new deal will be better than the old one. Dance, US and UN, dance.

The stock market continues bullish, but I must admit that it's also deceptive in that it constantly looks as though it wants to sell off -- but by the end of each day it's higher. In this market all classic valuations and historical models (cycles, Elliott, over-bought/over-sold studies, etc.) have proved (alas) to be useless. The only useful guide (as far as I'm concerned) has been my Primary Trend Index (PTI).

NEXT MAILING: March 11, 1998